





Lesson Plan

Income – Rental and Schedules K-1

Time Required: 60 minutes

Introduction	Objectives	Topics
This lesson covers the reporting of certain income from Schedules K-1 and the reporting of rental income and expenses. Schedules K-1 is in scope for Advanced and Rental Income and expenses is in scope only for the Military courses.	Identify Schedule K-1 income items that are within the scope of the VITA/TCE programs.	 Schedule K-1
	Determine how to report Schedule K-1 income items.	 Rental Income and Expenses
	Determine which types of rental income must be reported.	Depreciation Special Allocations
	Identify how to report rental expenses.	Rental Loss

Key Terms

Actual Expense Method: One of two methods for calculating business automobile expenses. For the actual expense method, the taxpayer determines the business portion of expenses for fuel, auto maintenance, parking fees and tolls, and auto loan interest. (The other method is the standard mileage method.) The actual expense method is out of scope for the VITA/TCE programs.

ADS: Alternative Depreciation System.

At-risk Rule: One of two restrictions on how much a loss from passive activity can offset other sources of income. Taxpayers are restricted from claiming a loss for more than they could actually lose from the activity; they can claim a loss only up to the amount for which they are personally at-risk in the activity. (The other restriction is the passive activity rule.)

Basis: The basis in a home is determined by how the taxpayer obtained the home. If a taxpayer bought or built a home, the basis is what it cost the taxpayer to buy or build that home. If the taxpayer inherited the home, generally the basis is its fair market value on the date of the decedent's death, or on the later alternate valuation date chosen by the representative for the estate.

Cash Method of Accounting: Accounting method that reports income when constructively received (not earned) and expenses when paid (not incurred), as opposed to the accrual method.

Depreciation: An annual deduction that allows taxpayers to recover the cost of property used in a trade or business or held for the production of income. The amount of depreciation depends on the basis of the property, its recovery period, and the depreciation method.

Investment Income: Investment Income includes taxable interest and dividends, tax-exempt interest, capital gain net income, net income from rents and royalties not derived from a trade or business, and net income from passive activities.

Modified Accelerated Cost Recovery System (MACRS): Depreciation method for property placed in service after 1986. MACRS calculates a taxpayer's depreciation deduction by using the property's placed-in-service date, recovery period, and depreciable basis.

Passive Activity: When a taxpayer receives income mainly from the use of property rather than for services. Passive activity means the taxpayer is not involved in making significant rental or business management decisions (versus active participation). Because rental activities are generally considered passive activities, rental losses may not be fully deductible.

Rental Expenses: Ordinary and necessary expenses attributable to the production of rental income and maintenance of the rental property, such as advertising, cleaning and repairs, insurance premiums, and property management fees.

Rental Income: Payments received by a taxpayer from tenants who rent the taxpayer's property, including regular and advanced rent, payments for breaking a lease, expenses paid by the tenant, and the fair market value of property or services received in lieu of monetary rental payments.

Schedule K-1 (Form 1041): Used by the fiduciary of a domestic decedent's estate, trust, or bankruptcy estate to report income, gains, losses, etc., of the estate or trust.

Schedule K-1 (Form 1065): Used by partnerships to report the taxpayers' share of the partnership's income, deductions, credits, etc.

Schedule K-1 (Form 1120S): Used by S corporations to report the taxpayers' share of the corporation's income (reduced by any tax the corporation paid on the income), as well as any deductions, credits, etc.

Standard Mileage Method: One of two methods for calculating business automobile expenses. For the standard mileage method, the taxpayer multiplies the business miles by the mileage rate for that tax year. (The other method is the actual expense method.)

Teacher Tips

Guidelines for Lesson

Guideline	Instructor Notes	Presentation Aids
Lesson background info	<p>Clarify that this lesson does not apply to taxpayers who are in the business of renting properties.</p> <p>Review the online demo of TaxWise on Rental Income.</p>	<p>TaxWise® Demo:</p> <p>From the Practice Lab, select:</p> <ul style="list-style-type: none"> • TaxWise IRS training • TaxWise Desktop Preparer with VITA/TCE Training menu or the TaxWise Online Preparer with VITA/TCE Training menu • Click the Income button, then select Part 2
Provide details and engage the students	<p>Discuss all tips and cautions in detail.</p> <p>Ask students to read and/or role-play examples and sample interviews.</p> <p>Review answers to each exercise; ask students how they arrived at their answers.</p>	<p>Internet:</p> <p>Link & Learn Taxes (L&LT) Advanced or Military level: Income – Rental and Schedules K-1</p>

Topic-specific Tips

Topic Name	Instructor Notes	Presentation Aids
Introduction	<p>Review lesson objectives.</p> <p>Point out that this lesson is the fourth of nine lessons on income.</p> <p>Review list of references.</p> <p>State the presentation time.</p> <p>Emphasize the need to ask taxpayers if they rented their home during the tax year or if they received a Schedule K-1 or Form 1099-MISC with no associated expenses.</p>	<p>Visuals:</p> <p>Form 1040, Page 1 Income section</p> <p>Form 13614-C, Page 2, Part III</p> <p>Form 1099-MISC, Box 2</p> <p>Form 1065 Schedule K-1</p> <p>Form 1041 Schedule K-1</p> <p>Form 1120S Schedule K-1</p> <p>Pub 4012, Income tab:</p> <ul style="list-style-type: none"> • Table A – Examples of Taxable Income

- [Examples of income items](#)

Direct students to Pub 4012, Table A – Examples of Taxable Income and point out rents, royalties, and certain income from Schedules K-1.

Internet:

[L< Income – Rental and Schedules K-1](#)

Review the key terms in the lesson.

Schedule K-1

Remind students that Schedule K-1 income that is in scope is limited to certain income topics.

Visuals:

Student Landing Page questions

Remind students that income is reported on Schedule E by entering a code 6 for royalties in Part I.

[Form 1065 Schedule K-1](#)

[Form 1041 Schedule K-1](#)

Review L< topic Schedule K-1.

[Form 1120S Schedule K-1](#)

Review the income reported on Schedule K-1 that is in scope.

[Form 1040](#), line 17

[Schedule E](#), Part I

Caution students that royalty income is in scope only when the source document of the royalty income is reported on Schedule K-1 or Form 1099-MISC, Box 2, Royalties with no associated expenses.

Pub 4012, Income tab, [Schedule E – Rental and Royalty Income and Loss \(Limited\)](#)

Internet:

Direct students to Pub 4012, Schedule E – Rental and Royalty Income and Loss (Limited) page

[L< Income – Rental and Schedules K-1](#), Schedule K-1

Rental Income and Expenses

Review L< topic Rental Income and Expenses.

Visuals:

[Schedule E](#), Part I

Prompt students to share what they know about rental income using the lesson questions.

[Schedule E Instructions](#)

Point out the following questions on Schedule E:

Pub 4012, Income tab, [Schedule E – Rental and Royalty Income and Loss](#)

- Question A

[Schedule A](#)

- Question B

[Pub 527](#)

Prompt students to give examples of deductible rental expenses.

[Pub 17](#), Chapter 9, Rental Income and

		Expenses
	<p>Remind students that the standard mileage rate for 2014 is 56 cents per mile.</p> <p>Ask students the John Princeton exercise question about splitting mortgage interest and taxes between Schedule A and Schedule E.</p> <p>Verify students understand the difference between repairs, which are deductible, and improvements, which must be depreciated.</p> <p>Demonstrate using the tax software by linking to Schedule E.</p>	<p>Internet:</p> <p>L&LT Income – Rental and Schedules K-1, Rental Income and Expenses/Other Deductible Rental Expenses</p> <p>FAQ, Can I claim rental expenses?</p> <p>Interactive Tax Assistant, Can I Deduct My Mortgage Related Expenses?</p> <p>TaxWise Demo:</p> <p>Form 1040, line 17 link to Schedule E</p>
Practice	<p>Review with students the Tax Map illustrated example for allowable rental expenses.</p> <p>Walk through L&LT Topic Activity - Tax Your Memory on slide 22, Florence's rental property with students.</p>	<p>Pub 527, Worksheet 5-1, Figuring Rental Deductions for a Dwelling Unit Used as a Home</p> <p>Tax Map, Rental Expenses – Illustrated Example</p> <p>L&LT Income – Rental and Schedules K-1, Topic Activity, Tax Your Memory, Florence's rental property, slide 22.</p>
Depreciation	<p>Review L&LT topic Depreciation.</p> <p>Ask: What are some examples of depreciable property? Answer: Buildings, machinery, furniture, vehicles, improvements to rental property.</p> <p>Ask students to describe the MACRS method of depreciation.</p> <p>Review examples and case studies with the class for basis and adjusted basis.</p> <p>Ask: What is needed to figure the MACRS deduction? Answer: Placed in service date, recovery period, and depreciable basis.</p>	<p>Visual:</p> <p>Pub 4012, Income tab, Schedule E – Rental and Royalty Income and Loss (Limited)</p> <p>Pub 946, Table B-1, Table of Class Lives and Recovery Periods</p> <p>Pub 527</p> <p>Pub 551</p> <p>Pub 946, Appendix A, Tables for Depreciation</p> <p>Schedule E</p> <p>Internet:</p> <p>L&LT Income – Rental and Schedules</p>

	<p>Ask students what are considered recovery periods under MACRS.</p> <p>Answer: It depends on the property class. Direct students to review the table in Pub 527.</p>	<p>K-1, Depreciation</p>
Special Allocations	<p>Review L&LT topic Special Allocations.</p> <p>Review the Gloria example with the class.</p> <p>Point out that taxpayers who rent out part of a property allocate mortgage interest and property taxes separately on both schedules (A and E).</p> <p>Remind students that rules for deducting expenses are different if taxpayers rent a dwelling unit that is also used for personal purposes.</p> <p>Review the rules for personal use test on using a dwelling unit as a home.</p> <p>Direct students to review the Worksheet for Figuring Rental Deductions for a Dwelling Unit Used as a Home in Pub 17, Chapter 9, Rental Income and Expenses.</p>	<p>Visuals:</p> <p>Pub 4012, Income tab, Schedule E – Rental and Royalty Income and Loss (Limited)</p> <p>Schedule E, Question 2</p> <p>Schedule A</p> <p>Pub 527</p> <p>Pub 17, Chapter 9</p> <p>Internet:</p> <p>L&LT Income – Rental and Schedules K-1, Special Allocations</p> <p>Schedule E for Topic Activity (Spencer)</p> <p>Answers for Topic Activity</p>
Rental Loss	<p>Review L&LT topic Rental Loss.</p> <p>Emphasize that passive activity losses can be deducted only from passive activity income. Taxpayers who are not active participants may not deduct rental losses that exceed rental income.</p> <p>Remind students to answer the question related to active participation in the worksheet below Schedule E in TaxWise.</p>	<p>Visuals:</p> <p>Instructions for Schedule E</p> <p>Pub 925</p> <p>Form 8582</p> <p>Internet:</p> <p>L&LT Income – Rental and Schedules K-1, Rental Loss</p>

Practice	<p>Select practice exercise for Form 1040 Income line 17.</p> <p>Ask students to select the problem based on their certification course of study.</p> <p>Verify students have correctly completed Schedules A, E, and Form 1040 line 17.</p>	<p>Publication 4491-W Military and International Comprehensive Problem and Practice Exercises</p>
Summary	<p>Review the lesson summary with the class.</p> <p>Review the out of scope issues with the class.</p>	<p>Visuals:</p> <p>L&LT Income – Rental and Schedules K-1, Summary</p> <p>L&LT Income – Rental and Schedules K-1, Click Assessments icon to review Summary and Exercises</p>

References	
L<	Income – Rental and Schedules K-1
Form 1040	Form 1040 , Line 17
Form 1040 Instructions	Form 1040 Instructions
Form 13614-C	Form 13614-C , Intake/Interview and Quality Review Sheet, Page 2, Part III
Form 1041 Schedule K-1	Form 1041 Schedule K-1
Form 1065 Schedule K-1	Form 1065 Schedule K-1
Form 1120S Schedule K-1	Form 1120S Schedule K-1
Form 8582	Form 8582 , Passive Activity Loss Limitations
Form 1040 Schedule A	Schedule A
Form 1040 Schedule E	Schedule E , Part I
Schedule E Instructions	Schedule E Instructions , page 2, At-Risk Rules and Passive Activity Loss Rules
Pub 4012	<p>Pub 4012, Volunteer Resource Guide, Income Quick Reference Guide, Income Tab</p> <p>Examples of Taxable Income</p> <p>Schedule E – Rental and Royalty Income and Loss (Limited)</p>
Pub 17	Pub 17 , Chapter 9, Rental Income and Expenses

Pub 4491-W [Pub 4491-W](#) – Practice exercise for Form 1040 Income line 17

Optional

Pub 527	Pub 527 , Residential Rental Property
Pub 541	Pub 541 , Partnerships
Pub 551	Pub 551 , Basis of Assets
Pub 559	Pub 559 , Survivors, Executors, and Administrators
Pub 925	Pub 925 , Passive Activity and At-Risk Rules
Pub 946	Pub 946 , How to Depreciate Property

Recommended Classroom Activities



Tax Facts



Assessments



Media: Videos
& Audio



TaxWise
Tutorial



Job Aids



Practice
Lab



Tax Facts: Link & Learn Taxes Income – Rental and Schedules K-1

Click Tax Facts as a new way to access Link & Learn Taxes Income – Rental and Schedules K-1.



Assessments – Summary and Exercises

Click Assessments as a new way to access the Summary and Exercises in Link & Learn Taxes Income – Rental and Schedules K-1.



Media: Video & Audio for Lesson

There is no media associated with this lesson.



TaxWise Tips and Resources for Lesson

TaxWise Screens	Form 1040, Income Schedule E – Rental and Royalty Income and Loss (Limited)
Practice Lab Tutorial	From the Practice Lab, select: <ol style="list-style-type: none"> 1. TaxWise IRS training 2. TaxWise Desktop Preparer with VITA/TCE Training menu or the TaxWise Online Preparer with VITA/TCE Training menu 3. Click the Income button, then select Part 2
TaxWise Solution Center	https://support.taxwise.com/



Job Aids – ITA and FAQs for Lesson

Tax Map	Rental Expenses – Illustrated Example http://taxmap.ntis.gov/taxmap/pubs/p527-002.htm#TXMP4b74bf17
FAQs	Can I claim rental expenses? http://www.irs.gov/Help-&-Resources/Tools-&-FAQs/FAQs-for-Individuals/Frequently-Asked-Tax-Questions-&-Answers/Sale-or-Trade-of-Business,-Depreciation,-Rentals/Personal-Use-of-Business-Property-(Condo,-Timeshare,-etc.)/Personal-Use-of-Business-Property-(Condo,-Timeshare,-etc.)-1
Interactive Tax Assistant	Can I Deduct My Mortgage Related Expenses? http://www.irs.gov/uac/Can-I-Deduct-My-Mortgage-Related-Expenses%3F
References	References for L< Income – Rental and Schedules K-1 http://apps.irs.gov/app/vita/content/12/references.jsp



Practice Lab

Practice Lab	http://www.voltaxprep.com/
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